



8011-01P  
SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-75157; File No. 10-214)

June 11, 2015

Automated Matching Systems Exchange, LLC; Order Denying an Application for a Limited Volume Exemption from Registration as a National Securities Exchange Under Section 5 of the Securities Exchange Act of 1934

**I. Introduction**

Automated Matching Systems Exchange, LLC (“AMSE”) believes that its proposed business model would qualify it as an exchange. As defined in Section 3(a)(1) of the Securities Exchange Act of 1934 (“Exchange Act” or “Act”), an “exchange” is “any organization, association, or group of persons, whether incorporated or unincorporated, which constitutes, maintains, or provides a market place or facilities for bringing together purchasers and sellers of securities or for otherwise performing with respect to securities the functions commonly performed by a stock exchange as that term is generally understood, and includes the market place and the market facilities maintained by such exchange.”<sup>1</sup> Under Section 5 of the Act, it is unlawful for an exchange to effect any transaction in a security, or to report such transaction, “unless such exchange (1) is registered as a national securities exchange ... or (2) is exempted from such registration upon application by the exchange because, in the opinion of the

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<sup>1</sup> 15 U.S.C. 78c(a)(1). Rule 3b-16 under the Act further provides that an organization, association, or group of persons shall be considered to constitute, maintain, or provide ‘a market place or facilities for bringing together purchasers and sellers of securities or for otherwise performing with respect to securities the functions commonly performed by a stock exchange,’ as those terms are used in Section 3(a)(1) of the Act, (15 U.S.C. 78c(a)(1)), if such organization, association, or group of persons: (1) Brings together the orders for securities of multiple buyers and sellers; and (2) Uses established, non-discretionary methods (whether by providing a trading facility or by setting rules) under which such orders interact with each other, and the buyers and sellers entering such orders agree to the terms of a trade. 17 CFR 240.3b-16(a).

Commission, by reason of the limited volume of transactions effected on such exchange, it is not practicable and not necessary or appropriate in the public interest or for the protection of investors to require such registration.”<sup>2</sup>

AMSE has chosen the latter option, seeking from the Commission an exemption from registration as a national securities exchange.<sup>3</sup> After a careful review of the exemption application, however, we have determined to deny it.

Although our review leads us to identify a number of potential issues that might warrant this result (including whether AMSE would even qualify as an exchange),<sup>4</sup> we find that the application is fatally flawed because AMSE is proposing to possess the broad regulatory powers and responsibilities that are reserved for self-regulatory organizations (“SROs”), while simultaneously seeking exemption from registration as an exchange.<sup>5</sup> Under the Act, for an exchange to possess the powers and responsibilities of an SRO, it must register as a national securities exchange. An exchange that is exempt from such registration does not meet the

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<sup>2</sup> 15 U.S.C. 78e.

<sup>3</sup> We note that, in a December 2014 public notice, the Commission expressly stated that it understood AMSE to be seeking an exemption under Section 5—not registration—and that AMSE did not respond otherwise. See Securities Exchange Act Release No. 73911 (December 22, 2014), 79 FR 78507, note 1 (December 30, 2014) (“Amendment Notice”) (“The Commission notes that AMSE’s application only seeks a limited volume exemption under Section 5 of the Exchange Act from registration as a national securities exchange under Section 6 of the Exchange Act. AMSE’s application does not seek to register as a national securities exchange.”). We therefore deem any claim to the contrary waived.

<sup>4</sup> See infra Section III.A.

<sup>5</sup> SROs are privately-funded entities, entrusted with quasi-governmental authority, which generally adopt rules to govern their members and enforce these rules as well as the federal securities laws. See generally Free Enterprise Fund v. Public Co. Accounting Oversight Bd., 561 U.S. 477, 484 (2010) (explaining that “private self-regulatory organizations in the securities industry—such as the New York Stock Exchange—... investigate and discipline their own members subject to Commission oversight”). The quasi-governmental authority afforded to SROs includes prosecutorial, adjudicatory, and rulemaking authority.

definition of an SRO under the Act. Moreover, the Commission has never allowed an exempt exchange to possess the broad range of regulatory powers and responsibilities of an SRO. We believe that doing so here would be contrary to the Act and inconsistent with the public interest and the protection of investors.

## **II. Background**

### **A. Procedural History**

On July 7, 2014, AMSE filed with the Commission an application seeking a limited volume exemption, under Section 5 of the Act, from the requirement to register as a national securities exchange under Section 6 of the Act.<sup>6</sup> Notice of AMSE's exemption application was published for comment in the Federal Register on July 29, 2014.<sup>7</sup>

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<sup>6</sup> In the interest of completeness, we note the events that preceded AMSE's filing of its July 7th application. From December 2013 through March 2014, staff had numerous communications with AMSE about its (then-draft) application, including multiple email exchanges and at least one phone call; during these exchanges, the staff explained that it was concerned that AMSE's proposed business model was not an "exchange." In March 2014, AMSE formally submitted a Form 1 application. On April 24, 2014, the staff returned AMSE's application because, based on its review, the staff believed that AMSE had erred in submitting an application for an exchange and instead should have submitted an application for a national securities association, a classification that the staff believed better fit with AMSE's proposed business model. On May 6, 2014, the staff had a phone call with AMSE in which the staff again explained its view that AMSE's proposed business model was not an exchange. On June 16, 2014, AMSE brought suit against the Commission in the U.S. District Court for the District of South Dakota seeking certain injunctive and declaratory relief in connection with its application. *See AMSE v. SEC*, Civ. 14-4095 (D.S.D.). On June 24, 2014, the Commission staff and AMSE reached an agreement pursuant to which AMSE would submit a new Form 1 application that would include certain additional information needed to complete the application and the staff would thereafter proceed to process the revised application for Commission consideration.

<sup>7</sup> *See* Securities Exchange Act Release No. 72661 (July 23, 2014), 79 FR 44070.

On October 23, 2014, the Commission issued an order instituting proceedings to determine whether to grant or deny AMSE’s exemption application.<sup>8</sup> In that order, the Commission explained that it “is concerned that AMSE’s exemption application does not meet a key threshold requirement for being granted an exemption from exchange registration—namely, that the applicant actually be an ‘exchange’ as defined under Section 3(a)(1) of the Exchange Act and Rule 3b-16 thereunder.”<sup>9</sup> The Commission specifically identified the fact that “it does not appear that any AMSE system would operate as an exchange by bringing together purchasers and sellers of securities.”<sup>10</sup>

On November 10, 2014, AMSE submitted Amendment No. 1 to its exemption application. Notice of Amendment No. 1 to AMSE’s exemption application was published for comment in the Federal Register on December 30, 2014.<sup>11</sup> In the notice, the Commission advised interested parties that it was considering potential “additional grounds for denial.” As the Commission explained, “AMSE’s exemption application states that AMSE would operate as a self-regulatory organization that would exercise self-regulatory authority over its members,”<sup>12</sup> but under the Act an exempt exchange is not an SRO; thus, “any attempts by AMSE to hold

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<sup>8</sup> See Securities Exchange Act Release No. 73419, 79 FR 64421 (October 29, 2014) (“Order Instituting Proceedings”).

<sup>9</sup> Id. at 64422.

<sup>10</sup> Id.

<sup>11</sup> See Amendment Notice, supra note 3. In Amendment No. 1, AMSE added language to Exhibit E that described proposed consolidated quotation systems and a proposed optional order router that could send orders between the distinct member-operated order books.

<sup>12</sup> 79 FR at 78508.

itself out as a self-regulatory organization while simultaneously seeking an exemption under Section 5 would be contrary to the Exchange Act.”<sup>13</sup>

On February 11, 2015, AMSE submitted Amendment Nos. 2A and 2B, along with a comment letter.<sup>14</sup> Among other things, Amendments 2A and 2B changed most of the application’s references to “self-regulatory organization” to “limited volume exempt regulatory organization.”<sup>15</sup> Notwithstanding this change in nomenclature, AMSE did not otherwise modify the accompanying description of the powers and responsibilities it contemplated possessing. In some instances, AMSE continued to refer to itself in terms that pertain only to SROs under the Act or implied that it falls generally within the category of an SRO and would exercise authority as such.<sup>16</sup>

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<sup>13</sup> Id. On January 22, 2015, the Commission provided notice of an extension of the time for the conclusion of the proceedings to determine whether to grant or deny AMSE’s exemption application. See Securities Exchange Act Release No. 74116 (January 22, 2015), 80 FR 4321 (January 27, 2015) (“Extension Notice”). The Extension Notice extended the time for the conclusion of the proceedings by 90 days, to April 24, 2015. Id. AMSE subsequently consented to an additional 60-day extension of the time for the conclusion of the proceedings to June 23, 2015. See Letter from Michael Stegawski, Chief Regulatory Officer, AMSE, to SEC staff, dated February 27, 2015 (“AMSE February 27 Letter”).

<sup>14</sup> See Letter from Michael Stegawski, Chief Regulatory Officer, AMSE, to SEC staff, dated February 8, 2015 (“AMSE February 8 Letter”). Attached to the AMSE February 8 Letter were five exhibits: Exhibit A – Amendment to Form 1 Application 2A, February 16, 2015 (“Amendment 2A”); Exhibit B – Amendment to Form 1 Application 2B, February 16, 2015 (“Amendment 2B”); Exhibit C – January 16, 2015 Correspondence – Paul G. Alvarez; Exhibit D – January 5, 2015 Correspondence – Michael Stegawski (“AMSE January 5 Letter”); Exhibit E – Discussion Draft – Form 1 Application, January 5, 2015.

<sup>15</sup> See AMSE February 8 Letter. We note that Amendment Nos. 2A and 2B appear to present different business models. We find it unnecessary to analyze these proposed alternatives separately, however, because both involve the same fatal flaw concerning AMSE’s proposal to exercise the panoply of self-regulatory powers and responsibilities. Further, we note that neither the Act, nor Form 1, nor the rules relating thereto provide for amendments in the alternative.

<sup>16</sup> See infra notes 23-29 and accompanying text.

The Commission received thereafter one comment letter from 1st Trade opposing AMSE's exemption application,<sup>17</sup> to which AMSE subsequently submitted a response.<sup>18</sup>

## **B. AMSE's Proposed Regulatory Functions**

In its exemption application, AMSE proposes that it would operate a marketplace for securities processing.<sup>19</sup> According to the application, persons seeking to buy or sell securities could only enter their orders through an AMSE member.<sup>20</sup> And pursuant to AMSE's proposed rules, any person may become a member of AMSE, provided that the person submits an application and complies with any conditions imposed by AMSE.<sup>21</sup> AMSE proposes a specific application form for broker-dealer firms to become its members.<sup>22</sup>

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<sup>17</sup> See Letter from Lori C. Sarian, Managing Partner, 1st Trade, to Kevin M. O'Neill, Deputy Secretary, Commission, dated April 14, 2015 ("1st Trade Letter"). This comment letter expresses concerns about an overall lack of clarity and detail in AMSE's application. This comment letter also raises concerns with respect to specific aspects of AMSE's application, citing, among other things, an ambiguity and vagueness surrounding membership qualifications and obligations, an unclear application process for certain potential members, proposed best execution obligations that may be inconsistent with industry standards, an inadequate description of operations and trade processing, inadequate issuer requirements, and the duplication of requirements for potential members who are already broker-dealers. Because the Commission's focus in this order is on threshold matters with respect to AMSE's application, many of 1st Trade's specific concerns are not addressed herein.

<sup>18</sup> See Letter from Michael Stegawski, Chief Regulatory Officer, AMSE, to Kevin M. O'Neill, Deputy Secretary, Commission, dated April 22, 2015 ("AMSE Response Letter"). The AMSE Response Letter provides responses to each of 1st Trade's specific comments. See supra note 17.

<sup>19</sup> See Amendment 2B, Exhibit E, Section A.

<sup>20</sup> See Amendment 2B, Exhibit E, Section E. The definition of "participant" was added to the AMSE rules in Amendment 2B. Participant means "a Person who has entered into a contractual agreement with an Exchange Member for the purpose of effecting transactions in securities or submitting, disseminating, or displaying orders." See AMSE Rule 1.5(w). In addition, Amendment 2B replaced the term "customer" with "participant" throughout AMSE's rules and other Form 1 Exhibits. See, e.g., AMSE Rules Chapters III, IV, VI, VII, XI, and Amendment 2B, Exhibit E.

<sup>21</sup> See AMSE Rule 2.3. Amendment 2B removed the requirement that AMSE members be registered broker-dealers. See Amendment No. 1, AMSE Rule 2.3. In addition,

Although AMSE’s application seeks approval as an exempt exchange, its proposal reveals AMSE’s aim to exist simultaneously as an SRO. Throughout its exemption application, AMSE refers to itself in terms that pertain only to SROs under the Act. For example, AMSE’s exemption application refers to AMSE’s rules being filed with the Commission under Section 19(b) of the Act,<sup>23</sup> which governs the filing of rules by SROs with the Commission.<sup>24</sup> AMSE’s rules also state that its disciplinary decisions and access decisions would be subject to agency review under the Act,<sup>25</sup> where such review is available only for the activities of SROs under Section 19 of the Act.<sup>26</sup> AMSE’s exemption application also repeatedly implies that it falls generally within the category of an SRO and that it would exercise authority as such.<sup>27</sup> AMSE also has stated in a comment letter that AMSE “will become a dedicated SRO for securities matching systems....”<sup>28</sup> Further, AMSE asserts that its members would hold a status under the Act that is only conferred on members of SROs.<sup>29</sup>

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Amendment 2B removed the requirement that AMSE members comply with Regulation ATS. See Amendment No. 1, Rules 15.1 -15.5.

<sup>22</sup> See Amendment 2B, Exhibit F and Rule 2.6(b).

<sup>23</sup> See AMSE Rule 1.5(b).

<sup>24</sup> See 15 U.S.C. 78s(b).

<sup>25</sup> See AMSE Rules 8.14 and 9.7.

<sup>26</sup> See 15 U.S.C. 78s(b), (d).

<sup>27</sup> See, e.g., AMSE Rule 1.5(j) (“a self-regulatory organization, other than the Exchange...”) and AMSE Rule 12.5 (“The Exchange may enter into one or more agreements with another self-regulatory organization to provide regulatory services to the Exchange to assist the Exchange in discharging its obligations under Section 6 and Section 19(g) of the Act....Notwithstanding the fact that the Exchange may enter into one or more regulatory services agreements, the Exchange shall retain ultimate legal responsibility for, and control of, its self-regulatory responsibilities...”).

<sup>28</sup> See AMSE Response Letter at 10; see also id. at 9 (AMSE states that it “will exercise self-regulatory powers.”).

<sup>29</sup> See AMSE Rule 1.5(l) (“An Exchange Member shall have the status as provided in Section 3(a)(3) of the Act or, where applicable, a Person operating pursuant to an

In addition, throughout its exemption application, AMSE proposes to perform regulatory oversight of its members that is consistent with the powers and responsibilities of an SRO.<sup>30</sup> Specifically, AMSE proposes to regulate its members with respect to: training, experience, and competence;<sup>31</sup> financial responsibility and operational capacity;<sup>32</sup> the maintenance of books and records;<sup>33</sup> business conduct;<sup>34</sup> anti-money laundering compliance programs;<sup>35</sup> extension of margin or credit;<sup>36</sup> custody of customer funds or securities;<sup>37</sup> fraud and manipulation;<sup>38</sup> and

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exemption from registration under the Act”). Section 3(a)(3) of the Act defines “member” exclusively within the context of either a national securities exchange or a national securities association, which are self-regulatory organizations. See 15 U.S.C. 78c(a)(3), (26).

<sup>30</sup> SROs’ wide-ranging responsibilities generally involve rulemaking, examining member firms for compliance with those rules and the securities laws (including the Commission’s rules thereunder), taking disciplinary action against members that fail to comply, and market monitoring, as well as professional activities such as testing, training, and licensing. See, e.g., 15 U.S.C. 78f(b)(1) (requiring a national securities exchange to be so organized and have the capacity to enforce compliance by its members and associated persons with the Exchange Act, the rules and regulations thereunder, and the rules of the exchange); 15 U.S.C. 78o-3(b)(2) (requiring the same of registered securities associations); 15 U.S.C. 78f(b)(2)-(10) (specifying requirements for the rules of a national securities exchange, including with respect to preventing fraudulent acts and practices, and with the discipline of members); 15 U.S.C. 78o-3(b)(3)-(15) (specifying requirements for rules of a registered securities association, including with respect to preventing fraudulent acts and practices, and with the discipline of members); 15 U.S.C. 78o-3(g)(3)(B) (providing that a registered securities association may bar natural persons from association with a member if the person does not meet standards of training, experience, and competence prescribed by rules of the association); and 15 U.S.C. 78q(d) (providing for allocation of examination authority across self-regulatory organizations).

<sup>31</sup> See AMSE Rule 2.4(b).

<sup>32</sup> See AMSE Rule 2.4(c)(1).

<sup>33</sup> See AMSE Rules 2.4(c)(2) and 4.1-4.4.

<sup>34</sup> See AMSE Rules 3.1-3.14.

<sup>35</sup> See AMSE Rule 5.6.

<sup>36</sup> See AMSE Rule 6.1.

<sup>37</sup> See AMSE Rule 10.12.

<sup>38</sup> See AMSE Rules 11.1-11.4.



compliance with broker best execution obligations.<sup>39</sup> AMSE also proposes to regulate the associated persons of its members and would require each member to establish, maintain, and enforce written supervisory procedures to enable the member to supervise the activities of its associated persons and to ensure their compliance with the securities laws, rules, regulations and statements of policy promulgated thereunder, as well as with AMSE rules.<sup>40</sup> Moreover, at times AMSE asserts that it is required to perform such functions under the Act,<sup>41</sup> implying that it will be an SRO, or acting in an equivalent, self-designated capacity it calls a “limited volume exempt regulatory organization.”<sup>42</sup> As the 1<sup>st</sup> Trade Letter observed, AMSE appears to be “attempting to operate with the most lenient regulatory constraints possible and in this attempt are circumventing many accepted practices and regulatory requirements.”<sup>43</sup>

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<sup>39</sup> See AMSE Rule 11.8.

<sup>40</sup> See AMSE Rule 5.1; see also AMSE Rules 5.2-5.5.

<sup>41</sup> See, e.g., AMSE February 8 Letter at 5 (stating “AMSE has expressly elected not to register as a broker-dealer and comply with the provisions of Regulation ATS and therefore is required to exercise self-regulatory powers.”); and AMSE Rule 12.5 (“The Exchange may enter into one or more agreements with another self-regulatory organization to provide regulatory services to the Exchange to assist the Exchange in discharging its obligations under Section 6 and Section 19(g) of the Act...”). Section 6 of the Act imposes regulatory obligations on national securities exchanges, which are self-regulatory organizations; Section 19(g) of the Act imposes obligations on self-regulatory organizations. See 15 U.S.C. 78f and 78s(g); see also 15 U.S.C. 78c(26) (defining self-regulatory organization to include registered national securities exchange, national securities associations, and clearing agencies).

<sup>42</sup> The term “limited volume exempt regulatory organization” is not a recognized term under the Act. AMSE created this defined term in its rules. See AMSE Rule 1.5(ee) (“‘LVERO’ means an entity exercising self-regulatory powers pursuant to an exemption from registration under the Act”). As noted above, prior to submitting Amendments 2A and 2B, AMSE had referred to itself as an SRO; AMSE replaced many of these references with “limited volume exempt regulatory organization” after the Commission explained in December 2014 its preliminary view that AMSE would not qualify as an SRO. Critically, AMSE did not accompany this nomenclature change with any meaningful limitations on the powers and responsibilities that it proposed to exercise.

<sup>43</sup> 1st Trade Letter at 3.

AMSE also proposes to require its members and their associated persons to agree to be regulated by AMSE and to recognize AMSE as being obligated to enforce their compliance with the Act and regulations thereunder.<sup>44</sup> AMSE also would require its members and associated persons to recognize AMSE as being required to discipline them for violations of the Act, including through: expulsion; suspension; limitation of activities, functions, and operation; fines; censure; suspension or bar from association with an AMSE member; or any other sanction determined in AMSE's discretion for violations of the Act.<sup>45</sup> Here again, these are powers and responsibilities exercised by an SRO.<sup>46</sup>

### **III. Discussion**

#### **A. AMSE does not appear to meet the definition of an “exchange.”**

At the outset, we note that AMSE has urged the Commission to conclude that AMSE should be granted an exemption from exchange registration under the Act. Certain provisions of AMSE's amended application indicate that AMSE's members may operate multiple distinct trading systems, under an AMSE umbrella, while other provisions indicate that AMSE itself would operate the proposed trading systems.<sup>47</sup>

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<sup>44</sup> See AMSE Rules 2.2 and 2.5(e).

<sup>45</sup> See AMSE Rule 2.2. AMSE's rules quote the language in the Act that gives national securities exchanges and national securities associations the authority to enforce compliance by their members with the Act. See 15 U.S.C. 78f(b)(6) and 78o-3(b)(7).

<sup>46</sup> See *infra* Section III.B.

<sup>47</sup> Compare AMSE Rule 11.8 (referring to participant orders being executed “on a designated trading platform, including that of a trading system operated by the Exchange Member”); and Amendment 2B, Exhibit E, Section D (requiring AMSE members to be responsible for having procedures for safeguarding their systems); with Amendment 2B, Exhibit E, Section A (“the Exchange will operate one or more fully automated electronic order books”); *id.* at Section E (“[o]rders of Participants shall be ranked and maintained in the Exchange's electronic books for orders”); and *id.* at Section F (“[o]rders shall be matched for execution...on the Exchange's electronic order book”).

These conflicting provisions make it difficult to ascertain the operation of the trading system. Moreover, the lack of detail and clarity in AMSE's exemption application prevents the Commission from understanding precisely how AMSE proposes to bring together the orders of multiple buyers and sellers and otherwise satisfy the definition of "exchange." Under these circumstances, we would have grave doubts as to whether AMSE could in fact qualify as an exchange exempt from registration under the Act. We need not reach the merits of this issue, however, because as we describe below AMSE's exemption application suffers from a separate, fatal flaw.

**B. It is contrary to the Act and inconsistent with the public interest and the protection of investors for an exempt exchange to exercise the powers and responsibilities of an SRO.**

Even assuming that AMSE were deemed to be an exchange, the Commission cannot find that AMSE should be granted an exemption from the requirement to register as a national securities exchange under Section 6 of the Act because the Commission believes that AMSE's proposal is inconsistent with the Act.<sup>48</sup> As described above, AMSE proposes to exercise extensive self-regulatory powers that are reserved under the Act for an SRO—indeed, the bulk of AMSE's rules are devoted to this proposed regulatory function, and at times AMSE even refers to itself as an SRO. But the Act does not afford the powers and responsibilities of an SRO to an

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<sup>48</sup> For a history of the formation and regulation of stock exchanges, see generally Concept Release Concerning Self-Regulation, Securities Exchange Act Release No. 50700 (November 18, 2004), 69 FR 71256, at 71257-58 (December 8, 2004); CHARLES R. GEISST, WALL STREET: A HISTORY (1997); MICHAEL E. PARRISH, SECURITIES REGULATION AND THE NEW DEAL (1970); JOEL SELIGMAN, THE TRANSFORMATION OF WALL STREET: A HISTORY OF THE SECURITIES AND EXCHANGE COMMISSION AND MODERN CORPORATE FINANCE (3d ed. 2003).

exchange that is exempt from registration, nor does it require an exchange that is exempt from registration to exercise such powers and responsibilities.<sup>49</sup>

Section 3(a)(26) of the Act defines an SRO, in pertinent part, as any “national securities exchange.”<sup>50</sup> An entity may only become a “national securities exchange” by registering under Section 6(a) of the Act,<sup>51</sup> as the Commission has previously explained.<sup>52</sup> And, although Section 5 of the Act permits an exempt exchange to operate lawfully without registering as a national securities exchange,<sup>53</sup> an exempt exchange is, by definition, not a national securities exchange,<sup>54</sup> and, thus, does not fall within the definition of “self-regulatory organization” under the Act. It necessarily follows that, were we to grant AMSE the exemption it seeks, AMSE

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<sup>49</sup> See supra note 41 and accompanying text.

<sup>50</sup> 15 U.S.C. 78c(a)(26) (defining SRO as “any national securities exchange, registered securities association, or registered clearing agency”). See generally Barbara v. New York Stock Exchange, Inc., 99 F.3d 49, 51 (2d Cir. 1996) (explaining that “[u]nder the Act, [a national securities exchange] ‘is a self-regulatory organization’”).

<sup>51</sup> “An exchange may be registered as a national securities exchange under the terms and conditions hereinafter provided in this section and in accordance with the provisions of section 19(a) of this title, by filing with the Commission an application for registration....” 15 U.S.C. 78f(a).

<sup>52</sup> In a previous order granting an exemption from registration under Section 5 of the Act, the Commission stated that “[b]y virtue of this exemption from registration, the Wunsch System falls outside the definition of a national securities exchange because the term ‘national securities exchange’ implies a registered entity (see, e.g., sections 3(a)(26) of the Act (defining the term ‘self-regulatory organization’) and section 6(a) of the Act.”). See Securities Exchange Act Release No. 28899 (February 20, 1991), 56 FR 8377, 8382 note 51 (February 28, 1991).

<sup>53</sup> To grant an exemption from the requirement to register as a national securities exchange, the Commission must conclude that, in the opinion of the Commission, by reason of the limited volume of transactions effected on such exchange, it is not practicable and not necessary or appropriate in the public interest or for the protection of investors to require registration. 15 U.S.C. 78e.

<sup>54</sup> It is self-evident that an exchange cannot be exempt, under Section 5, from registering as a national securities exchange under Section 6, while simultaneously existing as a national securities exchange under Section 6.

would not be entitled, much less required by the Act, to hold itself out as an SRO or to exercise the self-regulatory authority that is statutorily afforded to SROs.

Nevertheless, there remains the question whether, in our discretion, we could allow AMSE to exercise the powers and responsibilities of an SRO, notwithstanding the fact that AMSE, as an exempt exchange, would not meet the definition of an SRO. Although the statutory language does not unambiguously forbid such a result, we conclude that we lack the authority under the Act to permit an exempt exchange to exercise the powers and responsibilities reserved for an SRO. In our view, the Act reflects a deliberate balance between, on the one hand, granting SROs the broad, quasi-governmental authority that AMSE proposes to exercise, and, on the other hand, ensuring that an SRO's exercise of this authority is carefully checked by close Commission oversight.<sup>55</sup> Indeed, we believe this understanding is further supported by a primary Congressional purpose underlying the 1975 amendments to the Act,<sup>56</sup> through which "Congress specifically and importantly modified [the system of self-regulation in the securities industry] to enhance the SEC's oversight of self-regulatory organizations."<sup>57</sup> As the Senate Report accompanying the 1975 amendments explained, "[t]he SEC is charged with supervising the exercise of this self-regulatory power in order to assure that it is used effectively to fulfill the

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<sup>55</sup> See, e.g., In re Series 7 Broker Qualification Exam Scoring Litig., 548 F.3d 110, 112, 114 (D.C. Cir. 2008) (explaining that "[t]he Exchange Act reveals a deliberate and careful design for regulation of the securities industry" that "depends on the SEC's delegation of certain governmental functions to private SROs" and describing how this "delegation involves close oversight" by the Commission). See also S. Rep. No. 94-75, at 24 ("self-regulatory organizations exercise government power").

<sup>56</sup> Securities Acts Amendments of 1975, P.L. 94-29.

<sup>57</sup> NASD v. SEC, 431 F.3d 803, 807 (D.C. Cir. 2005).

responsibilities assigned to the self-regulatory agencies, and that it is not used in a manner inimical to the public interest or unfair to private interests.”<sup>58</sup>

Yet were we to allow AMSE to exercise the powers and responsibilities of an SRO without actually qualifying as such under the Act—i.e., without registering as a national securities exchange—we would be deprived of many of the means that Congress thought were critical for our effective oversight of the exercise of self-regulatory powers. By its express terms, the Act affords us such oversight authority only over an entity that qualifies as an SRO, which AMSE would not have done. Accordingly, if we allowed an exempt exchange to exercise the broad powers and responsibilities of an SRO, we would lack the authority over that exempt entity that we would normally have possessed over SROs to, among other things, “approve or disapprove the proposed rule change[s],”<sup>59</sup> “abrogate, add to, [or] delete from” an exchange rule,<sup>60</sup> review a final disciplinary sanction imposed by the exchange or any denial of access,<sup>61</sup> “suspend for a period not exceeding twelve months ... or to censure or impose limitations upon

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<sup>58</sup> S. Rep No. 94-75, at 23. See also id. at 22 (explaining that the 1975 amendments were intended to “clarify and strengthen the Commission’s oversight role with respect to the self-regulatory organizations”); id. at 23 (“The self-regulatory organizations exercise authority subject to SEC oversight. They have no authority to regulate independently of the SEC’s control.”); id. (explaining that an objective of the 1975 amendments was “assuring that the self-regulatory organizations follow effective and fair procedures, that their activities are not anticompetitive and that the Commission’s oversight powers are ample and its responsibility to correct self-regulatory lapses is unmistakable”). See generally Onnig H. Dombalagian, Demythologizing the Stock Exchange: Reconciling Self-Regulation and the National Market System, 39 U. RICH. L. REV. 1069, 1080 (2005) (“One of the principal changes [of the 1975 amendments] to the framework for exchange self-regulation was to impose greater limitations on the exercise of rule making and disciplinary authority by exchanges.”).

<sup>59</sup> 15 U.S.C. 78s(b).

<sup>60</sup> 15 U.S.C. 78s(c).

<sup>61</sup> 15 U.S.C. 78s(d)-(e).

the activities, functions, and operations” of the exchange for specified misconduct,<sup>62</sup> or “remove from office or censure” any officer or director of the exchange for specified misconduct.<sup>63</sup> We do not believe that such a result would be consistent with the Congressional desire, as revealed through the statutory language and the legislative history, that the Commission closely oversee the exercise of self-regulatory authority.<sup>64</sup>

This conclusion is consistent with our prior reading of the Act. As the Commission has previously stated, “any system exercising self-regulatory powers, such as regulating its members’ or subscribers’ conduct when engaged in activities outside of that trading system, must register as an exchange or be operated by a national securities association [which is also an SRO under the statutory definition]. This is because self-regulatory activities in the securities markets must be subject to Commission oversight under Section 19 of the Exchange Act.”<sup>65</sup> As we have explained, under our view of the Act, “any system that uses its market power to regulate its participants should be regulated as an SRO.”<sup>66</sup>

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<sup>62</sup> 15 U.S.C. 78s(h)(1). See generally S. Rep No. 94-75, at 34 (explaining that the oversight authorities under Section 19(h)(1) of the Act are “in addition to suspension and deregistration and are intended to provide more usable sanctions than the SEC’s traditional ‘big stick’”).

<sup>63</sup> 15 U.S.C. 78s(h)(4).

<sup>64</sup> We note that Congress also afforded the Commission authority to enlist the assistance of the federal courts in carrying out its oversight role. See S. Rep No. 94-75, at 35 (“Sections 21(e) and 21(f) [of the Exchange Act] would empower the SEC to apply to a federal court for an order to (1) enjoin the violation of the rules of a self-regulatory organization, (2) command a member of a self-regulatory organization to comply with the rules of such organization, or (3) command a self-regulatory organization to enforce compliance by its members with the Exchange Act, the rules thereunder, and the organization’s own rules.”).

<sup>65</sup> See Securities Exchange Act Release No. 40760 (December 8, 1998), 63 FR 70844, 70847 (December 22, 1998) (“Regulation ATS Adopting Release”).

<sup>66</sup> See Regulation ATS Adopting Release, 63 FR at 70859.

Accordingly, as we read the Act, an exempt exchange is relieved of the statutory obligations of a registered SRO but also forfeits the ability to exercise the statutory authority of an SRO. To the extent that AMSE desires to perform the extensive range of self-regulatory responsibilities described in its exemption application, it must qualify and register as a national securities exchange (or a national securities association).

In any event, even if we possessed the authority to grant AMSE an exemption notwithstanding its intention to exercise the powers and responsibilities reserved for SROs, we do not believe that doing so would be consistent either with investor protection or the public interest. In our view, when an exchange wants to exercise the broad powers and responsibilities that AMSE is seeking here, an exemption from registration is not appropriate because the Commission would lack sufficient oversight mechanisms to ensure that the self-regulatory authority is not exercised in a manner inimical to the public interest or unfair to private interests. The Commission's oversight responsibilities towards SROs has been a cornerstone of self-regulation from its inception.<sup>67</sup> Indeed, due to the potential harm to capital formation, investors, and the public interest that could result from the misuse of the securities markets, as noted above, Congress intentionally created a highly regulated environment in which SROs must be subject to close oversight by the Commission. Put simply, an entity seeking to establish and enforce a comprehensive regulatory structure with respect to the securities business of its broker-dealer members—including the full range of business conduct, financial condition, and regulatory compliance matters—could have a substantial impact on the way those members engage in the securities business and comply with the federal securities laws.<sup>68</sup> In our view, any such entity

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<sup>67</sup> See William O. Douglas, *Democracy and Finance* 82 (1940).

<sup>68</sup> See, e.g., *Securities Industry Study, Report of the Subcommittee on Securities*, Committee on Banking, Housing, and Urban Affairs, U.S. Senate, 93rd Cong., at 14



should be subject to full Commission oversight to assure its performance of such functions is consistent with the protection of investors and the public interest. For these additional reasons, in the exercise of our discretion under Section 5 of the Act, we would deny the exemption application.

Our conclusion today is not inconsistent with prior Commission practice. At the outset, we think it is important to observe that the Commission has rarely exercised its exemptive authority under Section 5—indeed, it has granted a limited volume exemption, as sought by AMSE here, on only two prior occasions in the past 79 years.<sup>69</sup> And while the Commission imposed certain conditions upon exemptions from exchange registration when it granted them, the exemptions and conditions thereto neither allowed nor required the exercise of the extensive

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(1973) (“The broad powers delegated to the exchanges and the NASD under the Exchange Act include the power to affect the interests of individuals and firms, both members and non-members.”).

<sup>69</sup> In 1991, the Commission issued a limited volume exemption from exchange registration for Wunsch Auction Systems, Inc. (“WASI”) (now known as “Arizona Stock Exchange”). See Securities Exchange Act Release No. 28899 (February 20, 1991), 56 FR 8377 (February 28, 1991) (“WASI Order”). WASI proposed to operate an auction trading system for after-hours trading three times a week, at a half an hour each. In 1999, the Commission issued a limited volume exemption from exchange registration for Tradepoint Financial Networks plc (“Tradepoint”) (now known as “Swiss Exchange”). See Securities Exchange Act Release No. 41199 (March 22, 1999), 64 FR 14953 (March 29, 1999). Tradepoint operated as a U.K.-registered trading facility and offered trading only in securities listed on the London Stock Exchange. Aside from these two exemptions, the Commission has only issued limited volume exemptions under Section 5 of the Act in the period from 1935 to 1936; the exemptions issued then were for a small group of municipally-based securities exchanges that were already in existence at the time of the initial adoption of the Act in 1934. See Securities Exchange Act Release No. 416, November 14, 1935 (exempting the Honolulu Stock Exchange, the Milwaukee Grain and Stock Exchange, and Minneapolis-St. Paul Stock Exchange); Securities Exchange Act Release No. 432, December 2, 1935 (exempting the Richmond Stock Exchange and Wheeling Stock Exchange); Securities Exchange Act Release No. 472, February 3, 1936 (exempting the Colorado Springs Stock Exchange); Securities Exchange Act Release No. 589, April 10, 1936 (exempting the Seattle Stock Exchange).

SRO authority that AMSE is seeking.<sup>70</sup> Moreover, although the Commission acknowledged in the Regulation ATS Adopting Release that an exemption under Section 5 could be available for an exchange that has self-regulatory attributes,<sup>71</sup> the Commission has never granted an

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<sup>70</sup> See Securities Exchange Act Release No. 416, November 14, 1935 (requiring the Honolulu Stock Exchange, the Milwaukee Grain and Stock Exchange, and the Minneapolis-St. Paul Stock Exchange to keep up-to-date and available to the public the data contained in the application for exemption, make and keep required records, provide reports as necessary, and provide in their rules that a willful violation of any of the exemption conditions shall be inconsistent with just and equitable principles of trade, and providing that the same restrictions with regard to the extension of credit for registered securities are imposed on securities listed on these exchanges, that members of the exchanges are subject to Commission-imposed financial responsibility rules and regulations, that the manipulation provisions of the Securities Exchange Act apply to the exchanges and their members, and that companies whose securities are listed on the exchanges are required to file with the exchange and Commission certain annual financial statements); Securities Exchange Act Release No. 432, December 2, 1935 (granting exemptions for the Richmond Stock Exchange and the Wheeling Stock Exchange upon the same conditions imposed on the exchanges in Securities Exchange Act Release No. 416); Securities Exchange Act Release No. 472, February 3, 1936 (granting an exemption to the Colorado Springs Stock Exchange upon the same conditions imposed on the exchanges in Securities Exchange Act Release Nos. 416 and 432); Securities Exchange Act Release No. 589, April 10, 1936 (granting an exemption to the Seattle Stock Exchange upon the same conditions imposed on the exchanges in Securities Exchange Act Release Nos. 416, 432, and 472); WASI Order (granting an exemption based on the condition that WASI (1) permit the Commission to conduct examinations; (2) comply with its agreement to report volume and price data to the Commission and to SROs, and provide other information (such as the identities of participants who have entered orders) to the Commission and the SROs upon request; (3) comply with its undertaking to implement procedures to conduct surveillance of its employees and adopt requirements to ensure the non-disclosure of confidential information; (4) suspend trading in any security subject to a regulatory halt for pending news called by the primary market for the security or during suspensions of trading ordered by the Commission pursuant to Section 12(k) of the Act, and consult with the Commission subsequent to an exchange or NASDAQ session in which an operational trading halt has occurred or a circuit breaker has gone into effect; (5) suspend any auction at the request of the Commission, assuming adequate notice is given, and (6) continue to comply with the capacity, security, and contingency planning guidelines contained in the Commission's Automation Review Policy).

<sup>71</sup> In the Regulation ATS Adopting Release, the Commission stated that it “believes that the low volume exemption continues to be appropriate for some exchanges, such as an exchange that, for example, disciplines its members (other than by excluding them or limiting them from trading based on objective criteria, such as creditworthiness), or has

exemption to an exchange seeking to carry out the broad range of self-regulatory functions performed by registered SROs, as proposed by AMSE.<sup>72</sup> Rather, the Commission has granted an exemption only once to an exchange with “self-regulatory attributes”<sup>73</sup> and, in that case, the exchange sought only to impose financial and operational standards as a condition for eligibility for trading.<sup>74</sup> The limited self-regulatory attributes in that case stand in stark contrast to the full scope of self-regulatory powers sought by AMSE here.

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other self-regulatory attributes that exclude it from the definition of alternative trading system.” See Regulation ATS Adopting Release, 63 FR at 70848, note 33.

<sup>72</sup> See supra notes 30 - 45 and accompanying text.

<sup>73</sup> The Commission notes the distinction between entities that display “self-regulatory attributes”—which implies having only a few features of an SRO, such as disciplining members for violations of its own rules—and entities seeking to exercise all or nearly all of the powers of SROs under the Act. As discussed above, AMSE’s application shows that it is not proposing merely to have a few self-regulatory attributes, but rather seeks to exercise the full range of powers available to SROs under the Act. See supra notes 30 - 45 and accompanying text. Under these conditions, the Commission continues to believe, as previously stated, that the SRO functions can be exercised only by an SRO, not an exempt exchange.

<sup>74</sup> See Securities Exchange Act Release No. 41199 (March 22, 1999), 64 FR 14953 (March 29, 1999) (order granting a limited volume exemption under Section 5 of the Act to Tradepoint).

**C. AMSE is mistaken in its interpretation of the relevant procedural requirements relating to its exemption application.**

AMSE has labored under certain misunderstandings of the relevant procedures throughout its interactions with the staff on this matter. To the extent that there is any ambiguity in these procedures, we take this opportunity to provide clarification. AMSE erroneously reads Rule 202.3(b)(2) of the Commission's procedural rules as establishing an enforceable right on the part of AMSE to require the Commission's staff to confer with AMSE. Rule 202.3(b)(2) provides, in relevant part:

Applications for registration as national securities exchanges, or exemption from registration as exchanges by reason of such exchanges' limited volume of transactions filed with the Commission are routed to the Division of Market Regulation, which examines these applications to determine whether all necessary information has been supplied and whether all required financial statements and other documents have been furnished in proper form. . . . The staff confers with applicants and makes suggestions in appropriate cases for amendments and supplemental information. Where it appears appropriate in the public interest and where a basis therefore exists, denial proceedings may be instituted.

AMSE appears to construe the second sentence in the quoted language above to establish a binding obligation on the Commission staff to work with AMSE to achieve Commission approval of its exemption application.

But the rule contains no such requirement; indeed, it does not prescribe any procedure that the Commission staff must follow when working with applicants on applications for registration or exemption from registration. To the contrary, when the rule refers to Commission staff conferring with applicants, it is expressly descriptive, rather than prescriptive, as to the staff's actions. And, critically, it provides only that the staff will "confer[] with applicants and make[] suggestions in appropriate cases . . . ."<sup>75</sup> The rule thus explicitly leaves it to the staff to

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<sup>75</sup> 17 CFR 202.3(b)(2) (emphasis added).

identify the situations in which it would be appropriate to confer with applicants.<sup>76</sup> It certainly does not (as AMSE appears to believe) entitle applicants to obtain guidance from the staff so that the applicants can repeatedly amend their applications before the Commission issues its final order.<sup>77</sup> In any event, as noted above, Commission staff in fact consulted with AMSE and provided views and input to AMSE about its application.<sup>78</sup>

#### IV. Conclusion

The Commission has reviewed AMSE's application for a limited volume exemption from registration as a national securities exchange and has determined, for the reasons described above, to deny AMSE's application.<sup>79</sup>

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<sup>76</sup> See, e.g., Dichter–Mad Family Partners, LLP v. United States, 707 F.Supp.2d 1016, 1042–43 (C.D. Cal. 2010), aff'd, 709 F.3d 749 (9th Cir. 2013) (dismissing plaintiffs' claims upon finding, among other things, that even though statute mandated that agency staff "shall" engage in certain conduct, such language was "modified by the discretionary 'as appropriate'" and thus statute conferred discretion upon agency officials). Cf. Nat'l Env't. Dev. Ass'n's Clean Air Project v. EPA, 686 F.3d 803, 813 (D.C. Cir. 2012) (concluding that the statutory phrase "as appropriate" conferred "significant discretion" upon the agency); Bear Valley Mut. Water Co. v. Salazar, No. 11-01263, 2012 WL 5353353 (C.D. Cal. Oct. 17, 2012) (same); City of Toledo v. Beazer Materials & Servs., Inc., No. 90-CV-7344, 1995 WL 770396 (N.D. Ohio June 14, 1995) (the same phrase in a federal regulation indicated that the described activity was "not mandatory").

<sup>77</sup> Nor does the rule contain any suggestion that, absent such a conference with the staff, the administrative record would be fatally deficient and any subsequent action by the Commission on the application would be improper.

<sup>78</sup> See supra note 6 (discussing communications between Commission staff and AMSE regarding AMSE's application occurring between December 2013 and March 2014).

<sup>79</sup> We note that, at times during the pendency of its exemption application, AMSE made unsubstantiated claims of bad faith on the staff's part. We see no indication of any bad faith, however. And in any event, we have reached our determination to deny AMSE's exemption application based on our own independent review of the application. Accordingly, we are confident that AMSE has had a full and fair opportunity to present its application to us for consideration and that AMSE has suffered no prejudice.

IT IS THEREFORE ORDERED, pursuant to Section 5 of the Act, that AMSE's application for an exemption from registration as a national securities exchange be, and hereby is, denied.

By the Commission

Brent J. Fields

Secretary

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